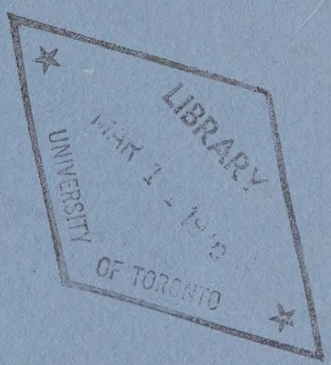
REPORT 4

ON

INSURANCE STUDY



TO

SUPERINTENDENT OF INSURANCE

MINISTRY OF CONSUMER AND COMMERCIAL RELATIONS

ONTARIO

Submitted by
Douglas H. Carruthers, Q.C.,
July 25, 1975

G. E. GRUNDY, F.C.A.
SUPERINTENDENT OF INSURANCE
REGISTRAR OF LOAN AND TRUST CORPORATIONS

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ONTARIO

MINISTRY OF CONSUMER AND COMMERCIAL RELATIONS

To Douglas H. Carruthers, Q.C.

The Superintendent of Insurance for the Province of Ontario hereby appoints Douglas Henry Carruthers, Q.C., as special legal counsel to study, with specific regard to the public interest, the relations between insurers and those served or benefited by insurance, including, but not so as to restrict the generality of the foregoing, the services, responsibilities and organizations of insurance agents, insurance brokers, insurance adjusters, insurance consultants and risk management consultants, and, for this purpose, to solicit representations and submissions, and, when deemed advisable, to conduct hearings and receive testimony, either verbal or written or both, and in consequence to make recommendations to the Superintendent of Insurance for the Province of Ontario, as appears advisable, to the end that the Superintendent of Insurance may report thereon to the Minister of Consumer and Commercial Relations.

Dated at Toronto this 30th day of January, 1973.

Superintendent of Insurance

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A COMMENT

Some of you may argue that "Half a loaf is better than none". I submit that in our complicated business, it may not be apparent to the buyer until it's too late, that he may just have half a loaf.

As an industry, we lose public credibility and support whenever any of our members offers contracts that are so restricted by their terms as to fall significantly short of meeting the buyer's needs as he sees them .....

Raymond L. Whaley, F.S.A., F.C.I.A., President of Canadian Association of Accident and Sickness Insurers and Senior Vice-President, Administration, Canadian Operations, Prudential Insurance Co. of America, in an address to the Annual Meeting of the Association, June 5, 1975, Ottawa.

1. FOREWORD

In preparing this series of reports I have had the benefit of information and opinions from many people inside and outside the insurance industry. I am grateful for their help. Most have spoken out of what I believe to be a conviction that there are deep problems in the industry to resolve. The sense of responsibility and the willingness to help that is apparent among a number of well informed individuals should prove to be a great resource.

Much help has been given by your own staff in providing statistics, background and informal views. Messrs. Lear P. Wood, B.Sc., F.C.I.A., and Ernest H. Miles, F.I.I.C., have been of particular help in this way. Your close personal involvement and encouragement from the beginning has been of great assistance to the management of the project; it has prevented any discontinuity as a result of the death of your predecessor, Gordon E. Grundy, F.C.A., who commissioned this study.

Naturally, I alone take responsibility for the views expressed in this report. In analysing and evaluating the information gathered I have had assistance from two colleagues, Peter H. R. Alley, M.B.A., C.A., and Donald N. Thompson, Ph.D., both in the Faculty of Administrative Studies at York University. I believe that the result of our hours of discussion and the writing of many drafts has been some insights into the problems of the insurance industry from fresh perspectives.

2. INTRODUCTION

The purpose of my enquiry has been to consider what changes might be appropriate from a consumer point of view in the regulation of relations among insurers, insureds and insurance intermediaries in Ontario. 'Insurance intermediaries', in the context of this study, means those individuals and firms who play a role between insurers and insureds and those employees of insurance corporations who deal directly with the public in the sale, distribution and servicing of insurance contracts. My letter of appointment is included as the first page in this report.

Report 1 analysed problems in the field of life insurance; Report 3 did the same for other-than-life insurance. Report 2 reviewed some portions of The Insurance Act and Regulations from an administrative point of view. In this report, the fourth, the main thrust is to put forward a model to show what a revised regulatory system could look like. At the end there is an outline of the next step, a preliminary test of the feasibility of the model.

A few key themes are embodied in the model which seem to be essential to any meaningful reform of the present system:

> First, a buyer of insurance must have available a great deal more information before he buys than he now gets. This is a large and complex problem. Without a thorough and radical approach to the disclosure issue the position of the consumer is unlikely to be much improved.

> Second, a body of advisers to consumers of insurance must be allowed to develop. Disclosure of adequate information to consumers is not enough. They must have access to unbiased and expert advisers who will act on their behalf to interpret the information.

> Finally, the system must allow the development of a wide variety of techniques for the marketing and distribution of insurance contracts and the delivery of services, a variety or mix that can be expected to change over time as conditions change.

Adoption of these key policies would require a much more detailed set of regulations, and a more responsive system of regulations than exist now. To implement them, either the Government would have to assume a much larger regulatory load than it does now, or the industry would have to assume responsibility for self-regulation. The model embodies the concept of self-regulation.

The model proposes a single system for the regulation of both the life and other-than-life segments of the insurance industry. A common approach can be taken along all the dimensions mentioned above - disclosure, expert advisers for consumers, variety of selling techniques and self-regulation. For example, the criteria for what constitutes adequate disclosure from a consumer point of view seem to be common to both segments of the business, although there is no question that the specifics of what must be disclosed would be different for an endowment life contract and for a fire

contract. From the regulatory system proposed in the model, detailed operating rules would be derived to provide for those differences that do exist between life and other-than-life areas, and among contract types.

Much more public exposure is required before further progress can be made with formulation of a new approach to insurance regulation. The conclusions from the earlier studies, together with the model presented in this report and the issues raised by it, need public scrutiny and criticism. A process to accomplish this is discussed at the end of this report.

3. SUMMARY OF CONCLUSIONS IN EARLIER REPORTS

The main conclusions reached in the previous three reports are as follows:

- The present legislation is in need of substantial revision, even to do well the job it appears intended to do.

  There are some changes that can be made in the existing legislation to allow for greater certainty, clarity and easier administration. These changes were discussed in Report 2.

- There are several areas in which the interests of consumers can be advanced by changes in the present legislation:

  It is not clear to the insured in whose interests insurance intermediaries act. This is the case in the buying and selling process of all insurance, and in the claims settlement process in other-than-life.

  Inadequate information on costs and benefits is available to consumers. The problem includes understandability of contracts, identification of hazards included and excluded, and the expected dollar value of benefits and costs.

  The claims settlement process, particularly in other-than-life insurance, is hard for the consumer to predict and unnecessarily frustrating for some claimants.

  It seems likely there would be substantial long-run cost benefits to the consumer from more price competition in the marketing of insurance.

- Many of the practices of the industry that give rise to problems, the frictions and the apparent inefficiences, seem to flow from an industry structure that is partly held in place by the present regulatory system.

To get at the source of the problems, changes in the regulatory system are needed.

- The most neutral approach would be to remove the regulatory props to the present structure.

Rather than changing the rules to specify a structure to replace the present one, it would seem more useful and less drastic to change the regulatory system to allow more freedom for the industry to adapt by itself.

- An attempt at a rationally systematic approach would seem to be more fruitful than a piecemeal approach. This is because the problems come from a structure supported by the regulatory system and they tend to be interrelated and complex.

To deal with some problems, without dealing with others, runs the risk of unbalancing the industry in unexpected ways.

4. BACKGROUND FOR THE MODEL

4.1 PURPOSES OF USING A MODEL

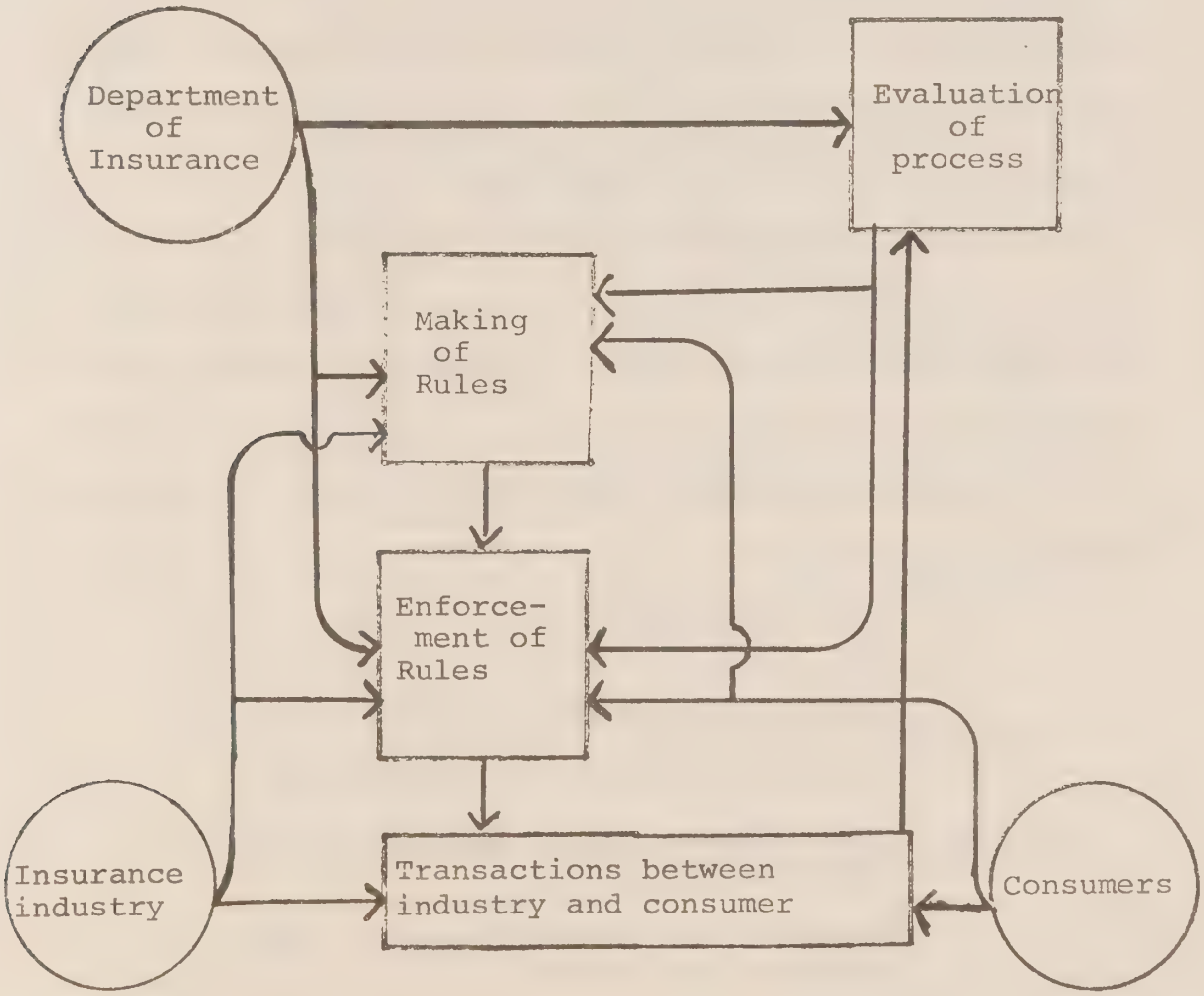
The word 'model' is used here in the sense of 'an example'; not in the sense of 'an ideal'. It is like an architect's model of a proposed new building, presented to help others get a feeling for the impacts of one possible solution to a problem. The purpose of presenting a model is to allow critical evaluation to expose problems and to draw out alternative suggestions.

A comparison between two models, one being what exists now and the other a new conception, can illustrate the issues involved. One comprehensive model is presented in detail followed by a discussion of alternative models in very broad terms.

4.2 MAIN CHARACTERISTICS OF THE MODEL

In contrast to the present system the model focuses on processes of regulation, rather than on prescription of a particular set of rules. The process in the model is based on self-regulation within the insurance industry.

The model emphasizes a system for making and applying rules. The process can be presented diagramatically.



One significant feature in the diagram is the separation of the functions of rule making, enforcement of rules and evaluation of the processes. Another is formal recognition of industry and consumer inputs to rule-making and enforcement functions. One task of the model will be to suggest an institutional framework for these features.

Although the model's emphasis is on process, it also outlines new kinds of regulation in the areas of disclosure and of the roles of intermediaries. Present regulation on disclosure is scant or non-existent. The introduction of more extensive regulation on disclosure seems to be essential to improving the buyer's ability to make rational insurance purchase decisions.

Existing role definitions for intermediaries do not appear to fit real needs of buyers. Therefore, some redefinitions of existing roles are included in the model.

The proposals that make up the model are organized into five broad areas:

1. Identification and clarification of the roles of intermediaries;
2. Institutional structure of the system;
3. Control of conduct and competence;
4. Disclosure of price, monetary benefits and contract terms;
5. Resolution of disagreements between insurers and insured.

4.3 GOALS OF THE MODEL

The model has been framed to meet the following constraints and objectives:

1. The regulatory system should function with the minimum involvement by government that provides adequate consumer protection.

2. Adequate powers must be conferred on regulatory bodies to make their activities effective.

3. The insurance regulatory system must permit a variety of roles within the industry, and multiple levels of competence within roles to allow specialization appropriate to the variety in consumers' needs.

4. The regulatory system must recognize the need for different rules for different classes of insurance.

5. The regulatory system must recognize that rules appropriate to high volume-low value transactions must, in some respects, differ from those appropriate to low volume-high value transactions.

6. The regulatory system must include processes for adapting rules as circumstances and needs change.

7. The adaptive processes should incorporate input from industry segments and the consuming public.

8. The system should allow (and encourage) innovations in contract terms and services.

9. The system should promote substantial competition on matters visible and important to consumers, including price and contract terms.

10. The system should encourage and provide processes for increased responsiveness to consumer needs.

5. THE MODEL

5.1 AN OUTLINE

Roles are redefined to make 'Who acts for whom?' easier for the consumer to understand. The terms 'agent' and 'adjuster' disappear. Agents become either 'sales representatives' or 'brokers'. Those presently licensed as adjusters become 'public claims advisers' and company employees settling claims become 'company claims representatives'. Brokers serve and are paid by only purchasers of insurance. One objective is to ensure that consumers have a strong body of competent advisers available to them.

Licensees will elect a Council composed of industry and public interest representatives to govern conduct, set and test for qualifications of intermediaries, and organize educational programs for them. The Department of Insurance will continue its enforcement role and will expand, and add emphasis to, its functions of enforcing rules, making disclosure rules and monitoring continuously how the system is working. The criterion is whether consumers' needs are being met.

Control of the conduct and competence of insurance intermediaries, to protect the consumer interest, is one main feature of the regulatory system. Licensing of appropriate intermediaries is a key tool in this process. Encouragement of good conduct and of

competence is provided by establishing codes of conduct, setting and testing for appropriate standards of qualifications and providing for educational programs and an appropriate environment for training. Constraints against bad conduct and incompetence are provided by a vigorous enforcement program and appropriate penalties. The control process covers both corporations and individuals but it forcuses on individuals, whether or not they are employees of a corporation. The objective is to provide a range of service, from the identifiably competent to the reliably mechanical.

Disclosure is another main feature of the system. Among the disclosure provisions is a requirement for clearer contracts with information provided on the expected monetary value of benefits, and on an insurer's mark-up on such benefits. The information disclosed will be available to consumers and to their advisers for expert analysis. The objective is to encourage competition on price and service levels in ways that will be visible to, and be of advantage to consumers.

To encourage fairer and speedier settlement of claims where disagreement exists on the amount of a claim, a change is made in arbitration procedures. The main improvements in claims settlement procedures are expected to come from the combined effect of advisers serving consumers, control of conduct and disclosure.

5.2 ROLES OF INTERMEDIARIES

5.2.1 Overview

Intermediaries' roles as currently defined in the Act are not consistent either with the real functions being performed or with consumers' needs. The roles have evolved over time and will continue to evolve. Some intermediaries have a role serving insureds, while others serve insurers. Insurance advisers may be one of the few groups of experts left by whom advice is offered on financial services without relationships and fee arrangements being clear to the parties involved. There is a need to redefine these roles now.

The essence of the following proposals is that:

1. 'Brokers' serve only buyers of insurance, with remuneration set by agreement between broker and buyer.

2. 'Agent' as a title disappears; those now licensed as agents would choose between becoming a 'sales representative' or a 'broker'.

3. A 'sales representative' serves only one insurer for each class of insurance, and his pay is a matter between him and his employer, the insurer.

4. A 'company claims representative' is licensed and use of the term 'adjuster' by company employees is prohibited.

5. 'Adjuster' as a title disappears; those now licensed as adjusters are called 'public claims advisers' and are expected to serve both insurers and insureds, although never both on the same claim.

6. Use of the term 'consultant' is confined to advisers who are qualified.

7. Corporations as well as individuals are licensed. Corporations are to a great extent treated as vehicles. The weight of the regulatory system falls on individuals, whether they work within or without of the framework of a corporation.

Brokers, public claims advisers and consulting actuaries who serve the public, constitute a class of intermediaries described as 'advisers'.

It is re-emphasized that these proposals apply to life insurance as well as to other-than-life insurance.

It is possible to conceive of other roles which might be fitted into the model. For example:

-some public claims advisers might be recognized and licensed to operate in restricted fields such as auto collision.

-qualified employees in responsible financial institutions, such as banks, trust companies and credit unions, might be allowed to sell a limited range of insurance contracts under restricted conditions.

-bona fide associations and clubs might be allowed to provide a limited range of insurance contracts to members for a fee to the members under restricted conditions.

The key objectives of the redefinitions of roles are to:

-eliminate confusion about whom each intermediary is serving:
clear responsibility is to be placed on those acting as brokers to exercise professional skills in understanding and prescribing to a buyer's insurance problem;

-ensure that there is adequate expertise available to consumers;

-ensure that there is a variety of intermediaries and a range of skills appropriate to the variety of consumers' needs.

5.2.2 Agents - Sales Representatives

PROPOSAL: Anyone selling insurance contracts for a single insurer is to be known as, and licensed as, a 'sales representative'. If the insurer does not sell all classes of insurance, a sales representative could sell for one other insurer in each insurance class. The term sales representative includes those now known as 'agents' who sell for a single company. It also applies to any present 'agent' now selling for several insurers who chooses to become a 'sales representative' rather than a 'broker'. Sales representatives obtain remuneration only from insurers. The sales representative has the legal status of an employee of the insurer. A sales representative is allowed to sell only the type of insurance contract for which he is qualified.

RATIONALE: The title 'agent' is done away with because it clouds the fact that the sales person is working for and paid by the insurer. Insurers who wish to control their sales effort completely should have employees who work solely in their interests, but with a title that makes their role clear to purchasers. By making it clear that a sales representative is an employee,

his role is defined for purposes of obligation, responsibility and liability.

TRANSITION: All those now classified as 'agents' will have to choose whether to become a 'sales representative' or a 'broker'.

ISSUES:

1. Is the title 'sales representative' the most appropriate term to use?
2. How should those who now work for 'agents' and are licensed as 'salesmen' be fitted into the model?
3. Should a 'sales representative' be allowed to serve more than one insurer provided the classes of insurance are different.
4. Should a 'sales representative' be allowed to serve more than one insurer for any one class of insurance?
5. Are the classes of insurance as presently defined adequate for the purposes of this proposal? Should the classes be consolidated for this purpose?

5.2.3 Brokers

PROPOSAL: Brokers have the role of assisting insureds in buying insurance contracts. They continue to be licensed and retain the title 'broker'. A broker has a professional's responsibility to analyse a client's insurance problem with care, to advise on the selection of appropriate insurance, to analyse the costs and benefits of loss reduction or risk reduction practices, and to obtain contracts with an appropriate balance of cost and benefit. In time it is hoped that many brokers would also become qualified to take on the role of public claims advisers for their clients; any individual may become licensed in both capacities. The fee for a broker's services is negotiated directly with the purchaser, and the broker is not allowed to receive any remuneration from an insurer, directly or indirectly. A broker has no financial interest in an insurer, or vice versa. Brokers and insurers must act towards one another in an arm's length relationship. Any funds a broker receives from an insured for payment of insurance charges must be deposited in a trust account for the insurer, and will be deemed received by the insurer. Such funds are not available for use by brokers.

4. Should the rules protect the collection of fees for the broker?

   (a) The rules might provide a right for a broker to add his fee to the insurer's charge and give a broker a prior right to withdraw his fee from funds received in trust for the insurer;

   (b) The rules might also provide that an insurer who bills direct may add the fee agreed on by a broker and the insured to his charge, and collect on the broker's behalf.

5. Should all those who are now licensed as agents be allowed to choose to become brokers? If some limit is drawn, what should it be? Should there be conditions, such as requiring further training within a stated number of years?

6. Should it be considered a breach of a broker's independence for him to be authorized to act on behalf of an insurer in issuing a binder, with no fee from the insurer?

7. Should a broker be allowed to (or alternatively be required to) become a public claims adviser?

5.2.4 Company claims representatives

PROPOSAL: Those employees of insurers who come in contact with the public on claims must be licensed and be identified as company claims representatives. They may no longer use the word 'adjuster' as part of their title.

RATIONALE: The consumer is entitled to know that the person sent to deal with claims is a representative of and working in the interests of the insurer. Such persons must be licensed for control purposes, and have a suitable level of qualification from a consumer protection point of view.

TRANSITION: Initial qualifications and tests for company claims representatives would be set. Insurers would present for examination those employees who are to deal with the public on claims. Those who pass would be licensed. Use of the term 'adjuster' would be discontinued as soon as the new regulatory system starts.

ISSUES: 1. Should there be any automatic qualification of those employees of insurers who now deal with the public on claims or should a test be required?

5.2.5 Adjusters - public claims advisers

PROPOSAL: Anyone who is not an employee of an insurer, who offers services in the insurance claims settlement process is to be licensed and known as a 'public claims adviser'. An exclusion is people whose primary expertise is in another field (law, medicine or appraisals) and who do not hold themselves out as expert in or offering services primarily for insurance claims work.

A public claims adviser may work for an insurer but he must also offer his services to insureds. He may not represent both an insurer and an insured in the same matter. He must keep an arm's length relationship with both insurers and insureds. He must receive his remuneration only from the person on whose behalf he works.

Any funds put in the hands of a public claims adviser by an insurer in settlement of a claim are trust funds held on behalf of whomever he is working for. If a public claims adviser acts for an insured and receives claim settlement funds, he is entitled to deduct his fee from those funds provided the amount of the fee has been agreed upon in advance. A public claims adviser is not allowed to charge a fee to an insured which is contingent on or expressed as a percentage of a claim, or to an insurer a fee which

is contingent on or expressed as a percentage of a reduction from a claim.

An individual or firm offering services as both a broker and public claims adviser may not do claims work for insurers.

When dealing with third parties on behalf of a client a public claims adviser must declare clearly that he is doing so and state who the client is. A public claims adviser may act as an arbitrator in a claims dispute. In that case, if he is the chairman or the sole arbitrator payment of his fee may be shared by the insurer and insured.

RATIONALE: In the claims settlement process there is need for a body of qualified claims advisers available to both insureds and insurers. Their title should reflect their role. Remuneration should come exclusively from the person on whose behalf the adviser acts. The fee involved must not be set in a way that could encourage dispute rather than resolution. Claims advisers who are also brokers, must be seen to be independent of insurers. Therefore they must not work for an insurer on claims matters.

TRANSITION: Persons at present licensed as adjusters would be licensed in the new system as public claims advisers. Those individuals dealing with claims who are employees of an insurer, and who are sometimes called adjusters, would not be allowed to become public claims advisers unless they subsequently passed the prescribed tests.

ISSUES:

1. What is an appropriate title for the role of public claims adviser?
2. Should there be separate classes of claims advisers serving insurers and insureds? There may not be enough work to support separate classes, expecially in smaller communities.
3. Should those permitted to do insurance arbitration work be separate from brokers or claims advisers? Much of the technical expertise for a claims adviser and an arbitrator in insurance disputes seems to be held in common.
4. Should there be classes of claims advisers with specialist expertise over and above a general expertise? For instance, a claims adviser might specialise in claims for fire or other classes of insurance. If so, what would be appropriate distinguishing titles?

5. Who should be included and excluded from the rules governing public claims advisers? What about people on the fringe such as investigators or appraisers who specialize in insurance matters? Does the proposed exclusion based on 'primary expertise in another field' and 'not holding out' have an appropriate effect?

6. Should people who specialize in appraisal of auto collision losses be given a formal restricted place among public claims advisers?

7. Should a contingency fee be allowed in some circumstances? To do so might allow lower income claimants to get help otherwise beyond their financial reach.

5.2.6 Consultants

PROPOSAL: Use of the term 'consultant' is restricted to describe those who have the attributes of independence and the highest level of competence in their role. It is, therefore, used only by brokers, public claims advisers and actuaries serving the public. Also the term is used only in association with a recognized description of the function performed by the person and with a recognized class of insurance in which he exercises that function. For example, a person might be described as a 'life insurance buying consultant' where 'life insurance' is the class of insurance and 'buying' is the function. No-one can call himself an 'insurance consultant' without an identifying tag. Since some roles actuaries have in insurance matters involve customer contact and others do not, and since they already have an intensive system of qualifications, their role in advising consumers is identified as 'consulting actuary'.

RATIONALE: The term consultant implies both independence and a high level of expertise. If the expertise is confined to one field, the term consultant may not be used to imply expertise in insurance matters generally. The nature of the service and its availability to the public should be evident in the way the term is used.

TRANSITION: The use of the term 'consultant' might be prohibited for three or four years after the start of the new system until the industry has readjusted itself and levels of competence have become clearly defined. 'Consulting actuary' would be an exception because the qualifications are already established and tested.

ISSUES:

1. Should the title 'consultant' in a field of expertise (i.e. buying, claims, actuarial) require a level of competence higher than that of ordinary qualified practitioners in that field?

2. Should the general term 'insurance consultant' be reserved only for a corporation or partnership offering the full line of insurance intermediary services: buying, claims advice and actuarial work?

3. Should there be a special class of individual generalist entitled to use the term 'insurance consultant'? Such an individual might not need the highest level of expertise in, say, claims work, but would instead be knowledgeable about buying and claims problems, and

perhaps also actuarial problems. In this approach the term 'insurance consultant' might apply only to individuals, not firms.

4. Should the term 'consultant' be allowed to be used by actuaries who offer services only to insurers?

5.2.7 Corporations

PROPOSAL: One or more persons carrying on a business as a broker, public claims adviser or actuarial consultant may incorporate, but the corporation, as well as responsible individuals within the corporation must be licensed. The corporation is restricted in that:

- the chief executive officer, or principal officer, in Ontario of a corporation must be licensed as an individual in the license category applicable to the main business of the firm (broker, public claims adviser or consulting actuary), and the chief executive officer is held responsible for the acts and conduct of employees of the corporation;

- no insurer can own directly or indirectly an interest in the shares of such a corporation, nor can it own an interest in an insurer; and

- the corporation must not engage in any business an individual licensee would not be permitted to engage in.

A single broker corporation can include brokers, public claims advisers and actuaries amongst its employees or directors. The claims advisers and actuaries of such a broker are not able to do work for insurers.

An insurer's sales representatives and company claims representatives are not permitted to incorporate.

There are separate rules of conduct for intermediary corporations and for their employees. The rules for corporations tend to focus on whether certain things are done or not done; the rules for individuals include questions of conduct and competence.

RATIONALE: Those who are acting as advisers to the public should be allowed to enjoy whatever advantages there may be in incorporation as long as the individuals in charge have full responsibility for the conduct of the corporation and its employees from the point of view of the public.

Full responsibility for an insurance contract and service under it must rest on the insurer without any distortion from an intervening corporate form. An employer-employee relationship between insurer and his representatives helps make the nature of the responsibilities plain because it leans on an established body of law. The licensing of a chief executive as an individual, as well as licensing of the corporation, means that a senior management individual is identified who can be penalized as well as the corporation

TRANSITION: Time should be allowed between passage of legislation and its effective dates, so that individuals and corporations have time to arrange their affairs to meet the new rules.

ISSUES: 1. Should ownership or control of an adviser corporation be confined to individuals who are licensees, or is the 'chief executive officer' proposal sufficient to ensure responsible and independent conduct? Should the focus be on licensing directors rather than either owners or the chief executive officer?

2. Should rules be established so that insurers' representatives could incorporate? How could it be made clear to insureds in whose interests the incorporated representatives act? How could a representative's corporation be prevented from acting as, or becoming, a screen for the insurer?

5.3 INSTITUTIONAL STRUCTURE OF THE SYSTEM

5.3.1 Overview

The model of the regulatory system needs an administrative framework. The framework consists of institutional structures and an allocation of administrative functions among them.

One goal of the model proposals is to provide more extensive regulation of conduct. The burden of devising detailed rules is placed on the industry.

A second goal is to provide a structure within which the industry, with public interest input, can carry out its responsibility of making regulations.

A third goal is to provide an institutional structure for discipline that has sufficient separation of powers to be fair, but is not so elaborate as to be unwieldy.

Finally, the government must play a role in evaluating the effectiveness of the regulatory system and altering the framework to make it more effective when necessary.

The bodies or institutions discussed in the proposals and the main duties they perform are as follows:

Institution	Function
Department of Insurance	
Policy section	Evaluate regulatory process.
	Make legislative proposals on framework including establishing types of licenses.
Registrar	Investigate and prosecute offences.
	Issue, revoke or suspend licenses.
Disclosure section	Formulate disclosure rules.
Insurance industry self-regulatory council	Formulate rules of conduct.
	Adjudicate complaints by the Registrar and recommend penalties for findings of misconduct;
	Establish standards for qualification for licensing, and approve individuals for licenses.
	Organize educational programs.
	Make recommendations to the Department on any insurance matter
Insurance industry association	Election of members of the self-regulatory council.

The insurance industry self-regulatory council will be referred to hereafter as the 'SRC'.

The proposed allocation of functions aims to put the main burden of work on the SRC and to leave the Department of Insurance with some levers to influence the SRC's activities without emasculating it. It also is designed

to require enough interaction between the Department and SRC that they can keep in tune. Since there is no tradition of self-regulation in this industry, it seems appropriate that the Government should maintain closer control and involvement than is common in the established self-regulating professions. The proposed interactions between Government and SRC are one way of approaching this problem.

5.3.2 Self-regulatory council

PROPOSAL: An insurance industry self-regulatory council (SRC) is constituted to be responsible for:

- making rules of conduct for members;

- hearing charges laid against members for misconduct under the rules and recommending penalties to the Registrar;

  The Registrar would apply the penalties recommended by the SRC; appeal would be directly to the Divisional Court;

- establishing and testing individuals for educational and other qualifications appropriate to each license category;

- organising and offering if necessary, the required educational programs;

- making recommendations to the Department on all insurance matters.

All the activities of the SRC are conducted with the interests of consumers being given first priority and the interests of members second. The SRC is composed of representatives of the insurance industry association and some representatives of the public interest, - people whose occupation or position makes them generally knowledgable and without bias in favour of any segment of the industry.

The Council is organized into committees to deal with specific functions. There are, as a minimum, separate committees for formulating rules of conduct and for hearing prosecutions by the Registrar.

The SRC has its own secretariat for administration of its functions.

RATIONALE: The industry has an obligation to control the conduct of its members in the interest of the public. It should be given the institutions and powers to do so.

People in the industry are likely at an early stage to be aware of problems that require new rules. Industry members are in the best position to fine-tune the rules to meet real problems and keep the rules up to date. A body such as the SRC should be able to act faster than the legislative process.

Responsibility for education combined with responsibility for making the rules, should create a positive preventive effect, as it does in some of the older professions, with emphasis on the spirit of the law as well as the letter.

Public interest representatives should be included on the SRC in sufficient numbers to be a vocal and constant reminder of where the SRC's first duty lies.

A single council for the industry is proposed instead of separate ones for each class of licensee. There are several reasons. One is that a consumer's problem is one whole insurance service problem, not separate problems with

brokers, claims representatives,insurers and so on. Another is that one can expect evolution in the roles of participants. Placing the regulatory function in role-centred bodies would probably result in the bodies being used to defend the role. A single body will provide a forum within which changes in roles can be worked out, with every interest group, including the public, being heard from. Note that the actual creation of a new class of licensee is in the hands of the government, which is a device to discourage the SRC itself from becoming an interest group defending the status quo.

By being responsible for hearing cases of misconduct the SRC keeps in close touch with an important indicator of how the rules are working.

Defining appropriate standards for qualification, doing the testing and designing the educational programs would promote competent conduct for each role.

By giving the SRC a positive duty to make recommendations to the Department, a valuable source of input to future policy is established. The SRC would be the forum within which industry groups would be expected to reconcile their views.

TRANSITION: Before a new regulatory system is adopted, a number of technical studies will have to be carried out under the Superintendent or some other public body. The devising of an initial constitution for the SRC would be one of these studies. Advice from the industry would be important input to the study.

ISSUES:

1. What should be the number and composition of the SRC?
2. Should the Superintendent have any power of approval or veto over changes in the constitution of the SRC? Should he have the right to take the initiative to make a change?
3. How should the SRC be funded? Would a tax or levy as a percentage of annual contract charges of insurers and fees of advisers be a reasonable way of allocating costs?
4. How many public interest representatives should there be?
5. Should SRC members be paid if they are industry representatives? - if they are public interest representatives? If so, how is the amount to be decided?
6. Should the SRC perform a mediation or arbitration role in disputes - between members of the insurance industy

association? - between brokers and public claims advisers and their clients? - between insurers and insureds?

5.3.3 Insurance industry association

PROPOSAL: An insurance industry association is constituted in which all licensees are members or represented.

RATIONALE: The purpose of the association is to elect members of the SRC.

TRANSITION: The transition to establishment of the association would be the same as for the SRC.

ISSUES: 1. What should be the relationship of the association to existing and successor industry groups? Should they become constituent components through which individual and corporate members select representatives on the SRC? Should individuals and corporate licensees be members in the industry association directly, electing SRC members directly? Should there be sections of the SRC that take over continuing functions of existing and successor industry groups, or should the existing and successor industry groups continue in addition to the association?

2. Should the SRC membership include representatives of corporations such as brokers and insurers? The model assumes it would.

3. How should voting for SRC members be arranged?

4. How many SRC members should there be as representatives of each category of licensee? Should there be representatives for each level of licensee within a license category? Should each category of licensee vote only for its own representatives or should voting for all SRC members be by all association members?

5. How are the public interest representatives to be nominated and voted for?

5.3.4 Department of Insurance

PROPOSAL: The Department of Insurance is organized to contain the following sections:

- Policy
- Registrar
- Disclosure

The Policy section is concerned with evaluating the effectiveness of the regulatory system and with identification of problem areas. It makes recommendations for legislative changes, particularly to the regulatory framework. It draws the attention of other sections of the Department and of the SRC to problem areas within their jurisdiction. To analyse and monitor the regulatory system requires people with expertise in the areas of: policy analysis, marketing, law, economic analysis, actuarial science, finance and statistics. While a small highly competent permanent staff is essential to manage the evaluation process, some of the expertise can be drawn as needed from outside the Department or even outside the Civil Service.

The Registrar's section is responsible for licensing and enforcement. Licensing includes issuing, revoking and suspending licenses as recommended by the SRC, and maintaining a register of licensees. Enforcement includes

investigating suspected breaches of regulations and rules of both the Department and the SRC. The Registrar prosecutes suspected infractions before the SRC and carries appeals to the Divisional Court if necessary. Enforcement is carried out in accordance with The Statutory Powers Procedures Act. An investigation by the Registrar is prompted by a consumer complaint, by complaints referred by the SRC, or it is started on its own initiative. Most categories of licensees are required to make annual returns of information, and test audits will be appropriate.

The Disclosure section develops all disclosure requirements for insurance contracts, including questions of price and terms, and the form and timing of disclosure. The rules are promulgated as Regulations or as guidelines to allow relative ease of amendment.

RATIONALE: Determination of policy and evaluation of performance is obviously a primary responsibility of the Department in the regulatory model. With the complexity of the insurance distribution system, it is necessary to apply constant monitoring and analysis to avoid obsolescence in the regulatory system. The Department needs to make use on a continuing basis of the best analytical resources available. This does not imply a large staff, but rather a highly skilled one. The

organizational separation of the evaluation function is designed to help preserve the objective of 'the consumer interest'.

The Registrar's role in enforcement forces the Department to keep in close touch both with problem areas, and with the SRC. It provides an important lever for the Department to control the system without dominating it. It may be the only way to have effective enforcement of rules against large insurers based outside the province, or even outside the Country. Most of the functions of licensing are already within the Department. It seems convenient to leave them there, under the Registrar.

The disclosure rule proposals represent a relatively new emphasis. The development of the rules needs the resources and the prestige of a Government Department, at least until the new system is established for a number of years.

TRANSITION: The transition in Policy and Disclosure may, of course, require some augmentation of the Department's present staff. More important, for both sections, would be the extent of preparatory work before they start to operate. With recognition of this problem in advance, the studies that lead up to the implementation of a new system can be designed to accomplish some of the preparation - in terms of models for policy analysis and for initial disclosure rules.

ISSUES:

1. Would it be more appropriate to place the Registrar within the SRC?
2. If the Registrar's functions are carried out within the Department, should the SRC carry on some enforcement activities with respect to members of the association, either instead of, or in addition to, what the Registrar does? For instance should the SRC investigate and hear all disputes between association members?
3. What information needs to be reported by insurers and intermediaries to the Department for its Policy, Registrar and Disclosure sections to perform their functions?
4. What powers should the Superintendent have to get additional information from the industry for system evaluation and for enforcement investigations?
5. Should the Superintendent be required to make public an annual report which gives his evaluation of the effectiveness of the regulatory process?
6. Should the application of penalties recommended by the SRC be automatic? If the SRC finds in favour of a person

charged, should the Registrar be allowed to carry an appeal to the Divisional Court?

7. Should the issuance of a licence be automatic if the person has met the qualifications set by the SRC?

5.4. CONTROL OF CONDUCT AND COMPETENCE

5.4.1 Overview

Conduct of corporations and individuals in the industry who have direct contact with the public as it buys insurance and makes claims must be regulated. The competence of individuals in contact with the public must also be controlled. Most insurance transactions are simple, and require a relatively low level of skills. Relatively fewer transactions are large and complex, and justify sophisticated skills. The existence of different classes of insurance adds yet another dimension. The net results are:

(1) a need for regulation which is both detailed and adjustable to changing circumstances; and

(2) a requirement for varying levels of skills, with ways of training and testing for them.

The foundation of control is a system of licensing. Each separate role requires a particular license. Within each license role for individuals there are levels for different competence levels attained. At least, there is a 'trainee' level and a 'qualified practitioner's' level. In some licensed roles an 'expert' or 'consultant' level may develop. The proposals that follow would have the effect of requiring the following initial license categories:

Individuals	Trainee	Qualified	Consultant
Broker	x	x	
Sales representative	x	x	
Company claims representative	x	x	
Public claims adviser	x	x	
Consulting actuary			x
Corporations			
Broker		x	
Public claims adviser		x	
Insurer		x	

Licenses are restricted to particular classes of insurance. There is no limit on the number of classes a person could be licensed to deal with. To obtain a license a person must meet qualifications set by the SRC. For an intermediary corporation these are objective and include financial ability to meet its commitments. Insurers already meet financial tests, and it is not proposed that the present arrangements for that aspect of control be altered. For individuals, whether independent advisers or employees of adviser or insurer firms, there are also tests designed to discover competence for their license category, level and insurance class.

To maintain a licence, a licensee (corporate or individual, insurer or intermediary) must abide by a code of conduct designed by the SRC.

Development of a code of conduct appropriate to each category of license is an important duty of the SRC in the encouragement of appropriate behaviour.

Definition of the levels of competence required for each license category, and design and organization of educational programs to train an adequate number of candidates, are the other activities of the SRC which will promote good conduct.

Balancing the encouragements for good conduct are penalties, ranging from minor ones to the ultimate of cancellation of license.

The control of conduct provisions encompass both corporations and individuals, but the weight of enforcement falls on the latter, whether they be employees, chief executives of a corporation or on their own.

5.4.2 License categories

PROPOSAL: The Superintendent of Insurance identifies occupations or roles, the levels within a role, and the insurance classes, which define a license category. He recommends that Regulations be issued requiring licensing for each such category. This applies both to individuals and to corporations.

RATIONALE: Individuals and corporations dealing with the public in the purchase and sale of insurance contracts and in claims matters need to be licensed. The license is the means of identifying persons qualified to carry on the business; its cancellation provides the ultimate protective sanction against bad practices. As the system matures, new occupations and new levels within roles will need to be licensed.

TRANSITION: Initially it would not be necessary to recognize any more roles of individuals than those described in the first section of the model. These roles are merely adaptations of the present roles. Two levels ('trainee' and 'qualified') might be sufficient for a start.

ISSUES:

1. What occupations and roles should be licensed?

2. How many levels should there be for licensing in a particular role?

3. Which classes of insurance should be segregated for separate licenses, and which combined? There are many possible variations. For instance there might be a separate license category for:

   i Each class of insurance

   ii Classes grouped very broadly into life and other-than-life

   iii Classes with an intermediate grouping, such as life, income benefits, auto, fire and other, or

   iv Classes grouped to give more recognition to market differences such as
   - life and income benefits for individuals
   - life and income benefits for groups
   - other-than-life for individuals
   - other-than-life for businesses.

4. Which classes are appropriate for sales representatives, for brokers, for claims representatives and for public claims advisers? It seems likely that for purposes of license categories, some roles or levels should encompass more classes of insurance than others.

5.4.3 Conduct

PROPOSAL: The SRC develops codes of conduct appropriate to each category of licensee. These codes focus on relationships between the licensee and consumers, but they also deal with relationships among licensees. The purpose is to identify positive acts that are the mark of competent service to consumers and to prohibit acts which are contrary to a consumer's interest.

The codes are tailored to the roles. For instance, codes for corporations tend to be confined to formal acts, such as delivery of disclosure statements or payment of settled claims within a set time. For employees of insurers (sales representatives, and company claims representatives) the rules are more subtle, for instance, requiring that the person identify himself and his purpose. For advisers the rules go much further, for example, they set standards of competence and diligent service in offering advice. At the highest levels, incompetence constitutes misconduct and may be grounds for loss of licence.

RATIONALE: Meaningful rule-making requires input from those who have practical experience in the business.

TRANSITION: Before the system becomes operative it would be necessary for the SRC to be established and to work out an initial set of rules. Some models might even be devised beforehand so that there is a good understanding between the Department and the SRC on the scope and direction expected in the rules. The operation of the SRC should lead to clarification and expansion of the rules in step with other developments in the system.

Results of hearings, and penalties imposed, should be well publicized in order to educate all licensees as quickly as possible.

ISSUES: 1. What are the precise criteria for 'good conduct' for each category of license?

5.4.4 Penalties

PROPOSAL: There are a range of penalties available for offences. Public notice of findings of wrong-doing and of the penalties applied, with publication of names, is an important part of the discipline process. Penalties are applied to both individuals and corporations, but there are some differences:

Type of penalty	Individuals	Corporations
-required to take a current course used for preparation of candidate for a license	Yes	No
-required to pass a current license qualification examination	Yes	No
-reprimand	Yes	Yes
-fine	Yes	Yes
-required to pay costs of investigation and/or hearing	Yes	Yes
-suspension of license	Yes	No
-cancellation of license	Yes	Yes
-for disclosure offences a consumer must be given notice and may be awarded a choice of interpretation or of recision rights in certain circumstances	No	Yes

The maximum fines for corporations are high, so that fines do not become a license fee paid for permission to breach the rules. One of the strongest impacts on corporations, adviser

corporations and insurers alike, is the application of penalties to individuals who are employees, including supervisory employees and the chief executive officer of an offending corporation.

RATIONALE: Most participants in the industry will continue to be motivated by a high sense of responsibility, especially when the individuals and companies are established in the community. For the protection of those who abide by the rules, as well as the protection of consumers, there must be a range of penalties for those who do not.

TRANSITION: There can be justification, with such a major change, for penalties in the first year or two to be kept light as a matter of policy, except in outrageous cases. This may be difficult to manage with fairness, and there is some argument for setting a firm precedent early. If a fair approach is taken from the start there should be no need for special transition provisions.

ISSUES:
1. To what extent should specific penalties be related to particular offences?
2. Should there be other penalties? Are any of the proposed penalties inappropriate?
3. Are the differences in penalties for individuals and corporations appropriate?

5.4.5 Qualifications and testing

PROPOSAL: The SRC determines the standard of qualification for each category of licensee. It also is responsible for testing to see that qualifications are met. The only exception is the liquidity tests for insurers which continue as under the present system. Qualifications must be tailored to the role, the level and the class of insurance. Some license categories at the trainee level need little more than evidence of character and financial responsibility; others require a high level of knowledge and competence.

RATIONALE: Responsible practitioners in the industry know best what level of competence is required for particular roles and can keep the standards up to date.

TRANSITION: 'Grandfather' provisions will allow those now licensed to be automatically licensed at a suitable level under the new system.

ISSUES:
1. Should there be a requirement to review standards of qualification at regular intervals?
2. How can tests be made to focus on competence in meeting consumer needs, and not merely test retention of knowledge?

This is an issue of importance especially at the higher level.

3. Should there be a requirement for periodic re-testing for a license to be maintained?
4. Should there be provision that all those acquiring grandfather licenses under the new system (or some classes of them) must take appropriate tests within a stated number of years in order to maintain their license?

5.4.6 Education

PROPOSAL: The SRC has a positive role to identify and arrange for educational programs appropriate to the qualifications for each category of license. Where such programs are not currently available, and cannot be provided by others (e.g. community colleges), the SRC has a responsibility and mandate to develop and offer them.

RATIONALE: Responsibility for conduct and competence has a positive and preventive side - provision of adequate training and education for performance of the task. The best control is to teach what should be done and how. Responsible participants in the industry are best able to identify what knowledge and training is required in specific roles, and to keep the program up to date.

TRANSITION: Existing programs run by organizations in the industry appear to provide a base from which educational programs tailored to the new license categories might be readily developed.

ISSUES: 1. What are the education requirements for each category of license? The answer must be a varying blend of directly usable knowledge and attainments that reflect relevant capabilities indirectly.

2. To what extent, if at all, should continuing education be required for the maintenance of a license?
3. Are there special educational programs that can be developed to teach parctitioners obtaining licenses under the grandfather clauses those skills that will be required of new candidates for a license?

5.4.7 Trainee

PROPOSAL: Every licensee at the 'trainee' level must operate under the authority of and responsibility of a licensee at the 'qualified' level.

RATIONALE: Assurance of adequate supervision on the job permits a reasonable, low cost entry to the trainee level while assuring the public that a satisfactory level of competence is being applied to work done on its behalf.

TRANSITION: Rules, penalties and enforcement procedures must be established which make a qualified licensee responsible for actions of trainees under his supervision.

ISSUES:

1. Should there be a limit on the number of trainees supervised by any one qualified licensed broker, public claims adviser, sales representative or company claims representative at one point in time?
2. What penalties, if any, might be appropriate for inadequate supervision?
3. How is the adequacy of supervision to be evaluated? How is the adequacy to be assured? Would it be useful for some roles (e.g. sales representative) to develop a special license category of 'supervisor' to whom trainees would be responsible?

4. What can be done to ensure that there is an adequate supply of trainees for each category of license? This gets into issues of adequate pay for trainees and enough places for trainees among employers in the industry.

5.5 DISCLOSURE

5.5.1 Overview

The disclosure provisions of the model are central. If a consumer is not able to get enough information to have a clear picture of what he is buying, he will find it difficult to make a rational buying decision. Hardly anyone would argue the consumer is not entitled to the facts. There are likely to be wide differences of opinion about what particular information he should have and how it should be presented. Perhaps this is why insurance may be the last frontier for modern style disclosure rules among financial services.

Discussion about disclosure tends to polarize between the options of showing all technical details and of revealing only such information as is most easily understood by a layman. In this model, it is not a question of either/or, but both. Even if a consumer cannot understand all the information provided, his qualified professional advisers can. What the advisers can use should be available to all. The general availability of information, even if it is used by only a few buyers, should have the effect of stimulating competition among insurers in matters of substance and of benefit to consumers.

Disclosure must be founded on visibility of product and price.

For product disclosure there is a need for standard terms of common contracts to provide a point of reference.

Yet to allow for product innovation, the use of standard terms must not frustrate the development of new product offerings to match new customer needs. There is also a fundamental need to make contracts more readable and understandable. The contract must state what is, and what is not, included in it, in a way a 'credulous' consumer can read and understand.

Included in product disclosure there must also be a clear description of the process an insured can expect to encounter in making a claim, including how disputes will be handled.

The term 'price disclosure' covers a wide range of matters. The key however is the separation of a charge for the contract (currently called a 'premium') into two components - the estimated financial benefit, or expected value, of the contract; and the insurer's mark-up on that amount in dollars. Techniques for analysing a contract charge into these two parts are available, although they are not widely used or understood. The development of approved standard analytical techniques will be necessary. In addition to the expected value, which is a summary measure, the proposals call for disclosure of the data from which the summary measure was constructed, and some evidence of past performance to assist in evaluating the insurer's claims, promises and forecasts. A supplemental set of price disclosure proposals is contained in an Appendix to this report.

The timing of disclosure as well as the content, is important. Clearly to be useful, there must be disclosure before a purchase is made. Equally, an insured is entitled to similar information before contract renewals or annual payments of contract charges.

Two constraints in specifying information for disclosure would be:

1. its helpfulness to a rational buyer
2. the feasibility of insurers producing the information

The particular compromise is a matter to be reassessed continually. For instance, because of the common use of computers and the relatively low cost of processing data, disclosure of many kinds of information is practicable today that was impracticable 10 years ago. The availability of certain kinds of information under these proposals is likely to lead to the development of new techniques for the rational evaluation of insurance contracts. This in turn may lead in the future to the need for new kinds of information, or information in new forms.

The transition to new disclosure rules is a formidable task that can be effected only by strong management. There are few precedents to follow. For these reasons development of disclosure rules is a function assigned to the Department in the model. In addition, it is envisioned that before a new regulatory system is adopted a number of technical studies would be carried out. One of these should

concentrate on the development of two sets of model rules for disclosure - one 'starting' set and one 'goal' set. These studies should be made with a thorough exposure to drafts to the industry before coming to final conclusions. Similarly, once the new system starts, the Department should decide on new rules only after receiving the views of the SRC. After some years, when a tradition of full disclosure is established, it is expected that the SRC could take the initiative in proposing improvements from a consumer point of view. When that stage is reached it might be feasible to move the disclosure rule function over to the SRC although investigation and prosecution of infractions would remain with the Registrar. These general comments on transition apply to the whole set of disclosure proposals.

5.5.2 Standard benchmark contracts

PROPOSAL: Standard forms of contract for the most common types of insurance must be developed. Types of insurance covered initially by such contracts might include ordinary life, endowment, term life, accident and sickness and annuities for individuals; group life, and group accident and sickness, and group pensions; fire and liability for homeowners and for tenants; automobile; fire and liability for businesses.

The insurer is not required to issue contracts in the standard form. However, contracts issued are required to show clearly in what respects they differ from the standard, and to indicate whether the difference is favourable or unfavourable to the insured in terms of benefits offered.

RATIONALE: Consumers have difficulty in understanding what benefits are or are not offered to them in insurance contracts. Therefore, they have difficulty in making wholly rational choices among contract offerings. This proposal provides model contracts as a reference point. Consumers would thus be assisted in seeing whether one contract offers more or fewer benefits than another. Consumers would also

be provided with a model of what is considered by informed or expert people, to be a reasonable contract for that type of insurance. By allowing insurers to diverge from the standard, flexibility is allowed for experimentation with extensions of benefits, or restrictions of benefits which result in offsetting price reductions.

TRANSITION: Introduction could take place over several years, with the initial standard contracts being for only the most widely used types of insurance coverage.

LSSUES:

1. For whom should standard contract terms be designed? For the risk-taker, the risk-avoider, or someone in between?
2. What would prevent an insurer from issuing a contract with so many trivial differences from the standard that the contract could not be understood? In this context the proposals on contract coverage and exclusions and on terminology should be considered.
3. What would be the criteria for deciding the types of coverage for which standard contract forms were needed?

5.5.3 Contract coverage and exclusions

PROPOSAL: Contracts must disclose plainly which losses are covered and which are not. The contract must also clearly disclose under what conditions losses otherwise covered will not be paid.

RATIONALE: 'Disclose plainly' is the operative term in this proposal. The problem here is that 'extent of coverage' 'exclusions' and 'conditions limiting coverage' are not clearly disclosed to ordinary buyers at present. These matters are usually in fine print, and often in subordinate clauses that are hard to read and understand. Existing statutory clauses are included in this criticism. While the use of standard contracts combined with disclosure of variations from the standard will help, it is not enough. Even a standard contract could include coverage or limitations which are not clearly stated. The objective would be to design contracts where important provisions show up clearly.

TRANSITION: The problem is a continuing one. It requires someone to apply a judgment to contracts offered in the market, to decide whether the objective of this proposal is met. In time, some criteria or rules may be established, but the issue will remain essentially one of judgment of the degree to which generally acceptable standards of clarity

have been met. Initially the judgments may receive more attention by coming from a government department. However, right from the beginning, industry input would be a helpful addition.

ISSUES:

1. What are appropriate criteria and rules for plain disclosure?
2. How can the degree of plain disclosure be measured?
3. Even if it could be measured, what is the minimum acceptable level of plain disclosure?

5.5.4 Terminology

PROPOSAL: Some terms in use in the insurance industry are confusing in that their meaning differs from the common usage of the same term. Such terms must be eliminated or changed. Some examples, with suggested alternatives where applicable, are:

Present term	Suggestion
agent	eliminate use of term
adjuster	substitute 'public claims adviser' and 'company claims representative'
comprehensive insurance	eliminate use of term unless there are no exclusions
dividend	substitute 'rebate on contract charge'
policy	substitute 'insurance contract'
premium	substitute 'contract charge'

Terms coined by an insurer to identify particular combinations of insurance types are prohibited, and the elements in the combinations are simply identified. For instance the term 'family insurance' is not to be used for a contract combining ordinary life and diminishing term. An exception to this provision is that certain combinations of insurance types can become standard contracts in their own right; a combination of fire, personal property and liability for houseowners is currently sometimes called a 'homeowners' policy and is a possible

candidate for this treatment.

RATIONALE: Consumers must be able to get a clear understanding of the nature of their insurance contract, and of their position vis-a-vis the insurer. Words used in contracts should not be industry jargon, but should have their usual meanings in English. Combinations of types of insurance must be clearly identified as to what is included. Differentiation among insurance contracts should reflect identifiable differences in benefit structure or cost rather than mere differences in nomenclature.

TRANSITION: At the outset only a change in key terms would be needed: e.g. agent, adjuster, policy, premium, dividend, and comprehensive. Other improvements could be made over a period of a few years.

ISSUES: 1. By what criteria will words be judged to be'jargon'? How will alternatives be decided upon?

2. How will it be decided that a particular combination of classes of insurance might usefully be to standardize as a unique contract; and that another combination of offerings, although useful to some buyers, does not deserve distinction as a type?

5.5.5 Calculating losses and settling claims

PROPOSAL: The process for calculating losses and settling loss claims must be described in the contract to the extent that general industry procedures are not established.

RATIONALE: How a claim will be dealt with is integral to the service being purchased, and must be understood in advance of purchase. The observed divergence between expectations and outcomes for insureds in claims settlement seems to be partly the result of inadequate disclosure about how losses will be calculated. Where an insured has a claim to make, the necessary steps to be taken are often not clear. He does not know what kind of evidence he may be required to furnish to prove the loss or its amount; and he does not know what recourse he may have against an unfavourable decision by the insurer.

To the extent that general procedures are not established for the industry, the contract should spell out the insured's position. Even where industry procedures do exist, there should be provision for putting information about them in the hands of insureds at appropriate times.

TRANSITION: Generalized industry procedures could become part of the code of conduct for insurers. Matters important for insureds for calculating losses and settling loss claims that are optional or not specified in such general rules, should be identified and be required in contracts.

ISSUES:
1. What methods and processes of calculating losses and settling claims should be generalized for different classes of contracts?
2. What methods and processes of calculating losses and settling claims should be described in contracts?
3. What claims procedures should be disclosed at the time of contract purchase? - at the time a claim is filed? - at the time there is a disagreement on the settlement of the claim?

5.5.6 Price and expected value of benefits

PROPOSAL: A buyer must be presented with selected summary financial information about the insurance contract he purchases together with detailed data from which the summary measures are calculated, and with historical evidence for those parameters which are forecasts or promises about the insurer's performance.

The basic summary measure is a calculation of the expected value of monetary benefits, which is sometimes called the 'pure insurance'. The consumer must also be shown the insurer's mark-up which is calculated by deduction of the expected value from the total charge for the contract.

The formula used for calculating expected values varies somewhat with the class of insurance, but in all cases it accounts for payments by the insured and possible receipts, modified by the probabilities of the receipts and the time value of money. Standard formulas must be established for each class and the relevant parameters must be disclosed to each purchaser. The parameters

represent such factors as risk class, interest rate, rebates on contract charges (currently called dividends) and probabilities of terminations. Finally on matters that are forecasts of the insurers performance, such as the rebates on contract charges, evidence of past performance is required.

RATIONALE: To make a purchasing decision, the consumer must be able to see clearly what he is getting, and what he is asked to pay for it. Because of the complexity of insurance as a financial service, some summary information is appropriately provided to the purchaser expecially on the expected values of monetary benefits. These proposals on financial disclosure are companion to those on insurance terminology, contract terms and standardized contracts. The objective of the combined proposals is to let a consumer relate price to benefits and to make comparisons with offerings of other insurance companies.

TRANSITION: The move to disclosure of price and the expected value of benefits may come about in many relatively small steps. It may be approached along two dimensions:

- disclosure requirements may be established class by class until they are defined for all classes of insurance;

- the list of items required to be disclosed can be added to, item by item. Initial requirements would be rudimentary with the expectation that within a few years they would become more refined.

However, the system must commence with a requirement for disclosure of the expected value of monetary benefits and of the mark-up for all classes of insurance.

ISSUES:

1. Is excessive information as confusing to the consumer as incomplete information?
2. What comprises too little information and what is too much? The differences in perception are likely to be related to who makes this judgment - whether he is an insurer, broker or a consumer spokesman.
3. What techniques are appropriate for presenting summarized information to the consumer? There are differences between what information is useful to an average buyer, and what is useful to a particular buyer - perhaps an informed one.
4. At what pace should the movement towards more complete disclosure of detailed data be pursued?
5. Some performance information can be shown at the level of the insurer's total business; and some at the level of his business in Canada

or in Ontario. Information can be shown in terms of all classes of insurance, or just in relation to a particular class or sub-class. Which level is most significant for disclosure?

6. Is it possible to meet the overall objective of consumer protection by providing for a 'short-form' of disclosure where annual premiums for a contract are less than some prescribed amount, say $100?

5.5.7 Price competition

PROPOSAL: An insurer is prohibited from offering a contract with different expected values of monetary benefits to insureds in the same risk class. But an insurer may offer different mark-ups or mark-up rates to purchasers, provided the differences are based on objectively identifiable characteristics and the rate differences and the characteristics are disclosed. For instance, purchases made through a broker are probably demonstrably less costly to service, and therefore could be sold at a lower mark-up.

Insurers are not permitted to agree to a common mark-up on contracts.

RATIONALE: Consumers are entitled to the long run benefits of competition among insurers in selling and administering insurance contracts efficiently. On the other hand, insurers should be encouraged to maintain expected benefits within actuarially sound limits, and to avoid positions that create pressure to reduce benefits below what was planned when the contracts were sold. This proposal and the other disclosure proposals are designed to focus price competition on the mark-up.

TRANSITION: This proposal goes with the other disclosure proposals. Therefore it must be implemented simultaneously with the other disclosure proposals.

ISSUES: 1. Can controls be established effectively so that an insurer offers the same expected value of benefits to insureds in the same risk class in a given period? How long should such a 'period' be?

2. Can and should controls be established so that an insurer offers the same mark-up to insureds who have a similar cost of being serviced?

5.5.8 Minimum benefits and prohibited terms

PROPOSAL: The use of certain terms in insurance contracts is against the public interest. There are certain minimum benefits a buyer must be able to count on if a contract for a particular type of insurance is offered at all. The rules identify prohibited terms and minimum benefits specifically. This proposal is separate from the proposal for 'standard contracts'.

RATIONALE: This proposal covers matters which must be dealt with by legislation rather than by rules of conduct. In the present regulatory system there are already provisions which serve as prohibitions and minimums. These should be identified specifically and codified in the regulations as provisions to protect the consumer from contract terms and price structures that are so extreme they are not in the public interest. The proposal is also explicit recognition of the need for Government to be able to express its policy in mandatory terms either to improve the position of consumers vis a vis insurers, or to integrate private insurance contracts with public policy. Examples of the problems that this proposal might deal with are:

- the rights of individual members in group contracts, against insurers and against a group manager (e.g. an employer) concerning disclosure, amount of benefits, claims, compulsory enrolment and other matters.
- integration of amounts of benefits and terms of income benefit programs with Government policy in social welfare and health programs.

TRANSITION: The present prohibited term and minimum benefit provisions would be identified and collected in regulations. Additional ones would be added as needs are identified.

ISSUES:

1. How are unacceptable terms and minimum benefits to be identified? To identify them requires a balanced understanding of industry problems and buyers expectations.
2. Do these proposals require the additional support of being in Regulations rather than in guidelines?
3. Should there be any restriction on the terms or benefits of unique contracts? Such contracts are different from contracts offered generally to the public, since even the wording may be negotiated.

4. For some kinds of contracts should the expected monetary value of benefits be required to be some predetermined proportion of the total contract charge?

5. Should there be an explicit organizational framework to ensure that regulation of this kind is affectively co-ordinated with Government policy and programs generated in other Departments and Ministries?

5.6 RESOLUTION OF DISAGREEMENTS

5.6.1 Overview

Clarification of roles, control of conduct and competence, and disclosure are all aimed partly at reducing unnecessary conflict between insurers and insureds. By encouraging the development of a group of public claims advisers who serve the needs of insureds as well as of insurers, the model takes a step towards equalizing the balance between insurers and insureds in coming to a settlement.

Procedures must be looked for to facilitate resolution of conflict outside of Court processes with less cost and less frustration. A redesigned system of arbitration for the resolution of disagreement on at least minor disagreements is proposed.

5.6.2 Arbitration procedure

PROPOSAL: In a contract of insurance there must be a standard arbitration clause whereby the insured can invoke compulsory arbitration when the amount in question is less than a prescribed amount. This includes situations where a dispute of any amount has a difference between conflicting positions of less than the prescribed amount. The arbitration is compulsory unless waived by the insured. This compulsory arbitration is on amount only, not on liability. Usual arbitration procedures, using two arbitrators and an umpire would be used, although by mutual consent the parties could agree on a single arbitrator. Where there is disagreement between the arbitrators, the umpire must pick one of the two values submitted to him as the value for settlement. Where there is only one arbitrator, by agreement, he too must choose one side's value or the other, and not compromise.

RATIONALE: Greater use of arbitration promises both lower cost and greater speed in the claims resolution process. Forcing a choice between the values submitted rather than allowing a compromise decision encourages each party to propose a 'realistic' rather than a 'bargaining' figure at an early stage in the process.

TRANSITION: Since it is envisioned that this arbitration procedure would become part of the contract rather than part of the Act as at present, it might be appropriate to begin when standard contracts start to be offered even though it is not proposed the arbitration provision should be optional.

ISSUES:

1. How big should the dollar difference between conflicting positions be to involve arbitration?
2. Should the arbitration be compulsory for the insured as well as for the insurer?
3. Should the umpire be allowed to compromise on amount, rather than select one of the two values submitted to him as the basis of settlement?
4. Should the SRC employ a small corps of arbitrators who for a modest fee could be sole arbitrators on small claims differences?

6. ALTERNATIVE MODELS

To put the model that has been presented in perspective, it is helpful to identify four general types of model that might be considered.

1. The system as it is.

> This approach tidies up inconsistencies and problems bit by bit, as circumstances demand. It is a reactive approach. It makes a major step, such as requiring disclosure, difficult to accomplish. The process of inducing change is one of changing Regulations and the Act bit by bit in unrelated steps.
>
> This approach is not far-reaching enough nor responsive enough to cover all the needs for change indicated in Reports 1 and 3.

2. Continue total reliance on government for regulation but expand scope of regulatory system.

> There is need for a great deal of new regulation to improve the position of consumers. This could be achieved by a much expanded set of Regulations and an enlarged department to administer and enforce them. The expansion would be by changing the Act and Regulations through the usual legislative process.
>
> This method makes revisions cumbersome. The resulting large detailed body of regulation is likely to become more rigid and less responsive than is desirable, given the speed of change in the environment. There would be no formal mechanism for the reconciliation of conflicting views, short of pressure groups and lobbying. Consumers are likely to be weakly represented in such a process.

3. Government regulation of insurers' activities in relation to insureds, combined with self-regulation of independent intermediaries.

The areas for regulation could be extended to include disclosure and role redefinition. Both the rule-making and enforcement functions could then be divided between the Government and self-regulation.

Insurers and their employees (salesmen and company claims settlement representatives) and disclosure rules could operate under rules made and enforced directly by the Department of Insurance.

Separate self-regulatory bodies could be established for each group of advisers, such as brokers and claims settlement advisers. These bodies would make and enforce their own rules.

Government regulation, while still more voluminous and detailed than at present, would be concentrated where skills are lower and acceptability of conduct is measured more by the carrying out or not carrying out of prescribed acts.

Self-regulation would be concentrated where skills are greater and conduct is measured in quality of work and independence.

This approach achieves many of the goals of the model presented in this report. The particular disadvantages lie in the rigidity and slower responsiveness in that part of the regulatory system in government hands, and the lack of a mechanism for balancing conflicting interests of different groups.

4. Industry self-regulation, with government activity concentrating on a supervisory and evaluative role.

This is the model that has been presented. It provides a forum for reconciling industry-wide views on problems with some informed public interest input. It balances speed and flexibility in adaptation of rules with the power of enforcement by the Government.

A characteristic of the model presented that could be offered by both alternative 2 and alternative 3, but not by alternative 1,is the provision of information for a rational choice in the disclosure rules, combined with two classes of advisers (brokers and public claims advisers) to help consumers use it. These two features gain strength from each other, but are relatively weak individually.

The model proposed may not be one the insurance industry can agree to accept. It needs their acceptance because they must be a working part of it.

Rejection by the industry of the model proposed would mean another must be chosen; total and expanded government responsibility for regulation; or self-regulation by some intermediaries and total government regulation of insurers and others. Whatever model is chosen, the problems identified in the earlier reports are what have to be dealt with.

An alternative that has not been discussed so far in this report is rate control by the government. If rate control could offer consumers assurance of lowest cost for the service delivered it is a choice that would merit attention, in spite of the obvious cost of carrying it out. It is attractive particularly in the perspective of existing conditions in which neither price nor the service offered is clear. Its attractiveness is deceptive. Because the service delivered by insurers is not uniform

(and does not need to be) and because the probability of loss discernibly varies among consumers, it is not possible to determine a single correct rate or even a maximum rate. For any given rate class the likely outcome will be that charges by efficient insurers will rise to meet a controlled or maximum rate while the service provided by inefficient insurers will decline. Neither outcome is to the benefit of consumers. The above comments assume the rate controlled is the total contract charge (presently known as the premium). To the extent that probabilities of loss are uniform, a better result would be obtained if rate control applied only to the expected monetary value of benefits; but such a plan would still be at the sacrifice of variety and innovation in contracts and services. Since rate control could be effective only in very limited conditions, it seems to have little promise as part of a general model. On balance, a system which allows consumers to see clearly the price and the nature of services offered for ready comparison with competitive offerings should be easier to manage, should provide lower prices for a given service level and should provide a wider variety of service levels.

Extensive consideration has not been given to the idea of the Government operating the insurance business. This is a radical change which goes beyond what I have been

charged with. As with rate control, overall efficiency gains are likely to be achieved only if uniformity of service level desired and uniformity of probability of loss exist. Another condition for success would be that there be something approaching universality in use of the class of insurance among the population in the Province. Health services obviously met all these criteria. By contrast, where consumers are to choose service levels to meet their own needs, where new service packages can be experimented with and where consumers need personal advice, government run insurance systems are unlikely to satisfy consumer needs. The requisite conditions for Government ownership are unlikely to apply to more than one or two classes of insurance, if any. Therefore there is still need for a general model of a regulatory system to deal with distribution problems of the privately owned insurance industry in the interests of consumers.

Finally, a word on the special problems of automobile insurance and the model. Since before this study started there have been studies going on towards improvements in auto insurance. These have involved industry groups working with your Department. I have tried to avoid overlapping these studies. At the same time I have attempted to keep myself cognizant of proposals being developed. The model presented in this report has been

developed in broad terms to encompass all classes of insurance, and provides at several places for the development of rules applicable to a particular class of insurance - for selling, for claims settlement and for disclosure. It seems unlikely proposals will be developed for automobile insurance that are so radical they cannot be fitted into the model.

7. TOWARDS A NEW REGULATORY POLICY

In my enquiry for you so far, here is what has been done.

- An analysis was made of both the life and the other-than-life insurance industries in terms of their relationships with consumers. Conclusions were drawn that there were gaps in existing regulations from the point of view of consumer interest, and that there are problems inherent in the existing industry structure which is in turn partially determined by the existing regulatory system.

- A review was made of the existing Act and Regulations. One conclusion was that the present legislation is in need of a major revision because some of it has little meaning, and other parts serve both industry participants and consumers badly.

- A model has been outlined to overcome deficiencies in the present system and to meet the needs identified in the analysis. The model helps to identify the policy issues in the reform process.

In looking at the problems to date, I have had many helpful interviews with representatives of nearly all segments of the industry and of your Department. The discussions have concentrated on enlarging my knowledge and understanding of the industry and its problems. In the course of these discussions many alternative approaches have been put forward for tentative consideration. Many of the concepts discussed have elicited a positive response which suggests the problems are real. I have had the experience, since writing my first three reports for you, of finding isolated instances of individuals in the industry voicing conclusions parallel or similar to some ideas in those Reports.

While all these responses show an encouraging interest in the problems, they do not appear to be founded on a broad and integrated understanding of the issues raised in my reports to you. Furthermore, any consideration of fundamental problems of the industry has so far been confined to a handful of individuals. The analyses and conclusions in these Reports have of course been prepared privately for you, and have not been discussed publicly. The model described in this report is a first effort at thinking in terms of an integrated, co-ordinated response to the problems.

One can forsee that the change process toward a new regulatory system must go through several steps.

1. The model should be exposed to selected members of the public for an initial reaction. What is needed is a critique of the model, particularly of the feasibility of implementing it.

2. Some body or group should be charged with developing a full and detailed set of policies for a new regulatory system and new regulations. The objective would be to deal with all the policy issues, prepare draft legislation, and prepare models of constitutions, rules of conduct and rules for disclosure.

3. If the self-regulatory approach were adopted there would be a one-time task in managing and transition to ensure that the self-regulatory system was effectively in place when the new legislation takes effect.

Exposure of the model is a necessary step before any further steps can be considered.

The model that is put forth in this report has had no outside critical evaluation. It is very much an unfinished initial proposal. What is needed is exposure to selected knowledgable individuals to test whether the model, or some variation, is likely to be workable. The point is not to see whether the model would be applauded, but rather to see whether there are practical obstacles to implementation, and to use it as a basis for fruitful discussion.

Two or three people should be selected from each present group within the industry (e.g. life insurance companies, brokers, other-than-life agents, adjusters, industrial buyers, consumers and others) to provide

input to the report. In addition there should be thorough exposure within your Department which represents an invaluable resource of experience and industry knowledge to bring to bear on the issues.

The selected individuals should be given a copy of this report to study for a week or two. Then they should be invited in groups of five or six to meet with myself and my colleagues to discuss the proposals. It would probably also be useful to have one or two people from your Department present at each meeting to observe the reactions. From what is brought out at these meetings it may be possible to make some practical changes to the model. In any case, an assessment of the reactions observed will help in reaching a decision on the next major step.

In preparation for such a series of meetings with industry members, similar meetings should be held with you and your senior staff.

This step can begin now.

APPENDIX

MORE ON DISCLOSURE

The model in the main text calls for much more information to be made available to purchasers. This appendix provides greater detail on what is envisaged.

From the analysis in Report 3 (Section 2.7), the issues on which a consumer needs information to make a rational decision, generalized for both life and other than life, are:

1. expected monetary value of benefits in the contract;
2. mark-up on the contract;
3. total charge for the contract;
4. data (dollar amounts,yield rate, dates and probabilities) from which expected monetary value of benefits is computed;
5. risk class the insured is placed in by the insurer;
6. stringency or liberality of the insurer in accepting an insured into a given risk class;
7. stringency or liberality of the insurer's claims settlement practices;
8. what accidents or events the insured is covered for;
9. what the insured is not covered for, including how he might lose coverage;
10. how the insured's loss claims are to be calculated and verified.

While all these matters reflect information which a rational buyer might like to have, it is not possible to obtain all of it with certainty. On some, such as an insurer's claims settlement practices, direct measures are difficult to devise. These problems are discussed at greater length in Report 3. Where direct measurement is not possible but

where forecasts and estimates of future behaviour are relevant, selected measures of past performance may be available to throw an indirect light on the problem. The operational questions are 'Which information'? and 'How should it be disclosed'?

The proposals in the main text of Report 4 and on the following pages suggest one model.

Disclosure - Expected value of monetary benefits

PROPOSAL: An insured must disclose to a purchaser, the expected values of monetary benefits. Expected value is a summary measure of financial benefits. It is derived from the detailed financial terms of a contract, modified by the probabilities of the occurence of events, and the concept that to have a dollar today is worth more than to have a dollar next year (even apart from the question of inflation). In life insurance, the concept of the time value of money and the probabilities of living or dying and other termination inherent in this proposal are particularly important.

RATIONALE: Detailed information on monetary benefits is required, but this may be so complex that most potential buyers will need to see it summarized to be able to comprehend it. The summary measure is also needed as an estimate of the value of the services being purchased, to be used in comparison with offerings of similar contracts by other insurers and to relate to the total contract charge i.e. the insurer's total charge for the period for the contract. Separate disclosure of expected benefits may lead buyers to choose the level of benefits that best suits them.

TRANSITION: Separate rules for calculating expected value of monetary benefits must be established for each class of insurance.

ISSUES: 1. What probabilities and factors must be used in calculating expected values for life insurance?

(a) Mortality tables used by the company in establishing its contract charge, those used for liquidity tests, or some other standard?

(b) Probabilities of termination of a contract used by the insurer in establishing its contract charge, or those experienced by the insurer in its recent past for that class of policy or for all classes, or an industry average?

(c) A discount rate for the value of future money that is used by the insurer in establishing its contract charge, or by the insurer for liquidity tests, or that might be used by an 'average' insured?

(d) In what detail should these probabilities and rates be disclosed?

2. What formulas for calculating the summary measure are most appropriate in each class or contract type of life insurance?

3. Can 'approved' formulas be developed for evaluating life insurance and income benefit insurance that can be made available to commercial data processors? This might allow the consumer to insert his own measure of the time value of money and his own estimate of some of the probabilities.

4. What are the dollar amounts to be used for the expected value of benefits (i.e. loss claims to be paid) for other-than-life?

The present state of accounting for insurance companies does not provide a usable standard. A study group of The Canadian Institute of Chartered Accountants has recommended standard principles for the industry. If standard accounting principles are adopted, then the basic measure used for the company's profits might serve for disclosure. An alternative is to use the basic measure used for the liquidity test. The liquidity test should probably show a larger expected value than is appropriate for either profit measurement or disclosure. What are the merits of alternative ways of measuring expected values?

Disclosure - Details

PROPOSAL: Details of financial terms, and probabilities used to compute the summary measures, must be disclosed. The particular details vary by types of contract.

RATIONALE: The insured must be informed of possible financial benefits, the probabilities, and when they may occur, since this is the basic data on which any purchasing decision must be based. In addition, because single measures of the expected value of benefits can show similar values for differing combinations of underlying data, the buyer should be given all the particular data used. This disclosure also enables him to apply an evaluation technique of his own choosing.

TRANSITION: Disclosure of this information could start at the beginning of a new regulatory system. The specific information to be disclosed for any given type of contract could be defined initially, and the definition could be amended later. Some life insurers already disclose some of the information required.

ISSES: 1. Which specific terms need to be disclosed for each type of contract?

2. Can pre-purchase information be reduced by separating what is needed at the time of the purchase decision, from what is needed only subsequent to purchase?

Disclosure-Mark-up and total contract charge

PROPOSAL: The mark-up and the total contract charge must be disclosed by the insurer to the potential purchaser. The mark-up is the difference between the expected value of monetary benefits and total contract charge.

RATIONALE: The mark-up covers the insurer's operating costs and profit, after taking account of his investment income. The more efficient the insurer is at operating and investing, the lower he can set his mark-up and still be profitable. Competition that drives down mark-ups helps induce efficiency among insurers. To the extent that competition is focussed on the mark-up rather than on the expected values of monetary benefits, the underwriting process is protected from inappropriate pressure on benefit pay-outs. When, as now, competition is focussed exclusively on the total contract charge, insurers are tempted to offer contracts that will have lower pay-out benefits rather than higher. This induces a narrowing of the range of service level being offered to consumers.

TRANSITION: The disclosure of mark-ups for a class of insurance would come into effect along with the disclosure of expected value of monetary benefits.

ISSUES: 1. Are the terms 'mark-up' and 'contract charge' appropriate?

2. Is mark-up adequately defined? Its definition is dependent on the definition of expected value of monetary benefits, so all the issues pertinent to that proposal are pertinent to this.

Disclosure - Risk class

PROPOSAL: The buyer must be shown what risk class he is assigned to, and what conditions apply for being in that class as distinguished from at least the next most favourable class.

RATIONALE: The basis for a lower risk class is a lower probability of loss. The usefulness of risk class disclosure lies in identification of the criteria that discriminate between one classification and another.

A consumer should be allowed to choose betweenchanging his circumstances in order to change his risk class, or accepting the class he is in. If the insured is not aware of the risk class he has been placed in, and what defines it, he does not have the opportunity to change those conditions which might permit a more favourable classification.

The ability to compare the risk classification offered him by different insurers, permits a buyer of insurance to seek out the insurer offering the most favourable classification.

TRANSITION: Disclosure of risk classifications could begin with the start of a new disclosure system. The only reason for delay might be to develop

standard definitions of the discriminant characteristics between risk classes if that were desirable.

Issues: 1. Should there be standardized risk classes, given that the development of new identifiable risk classes is one of the keys to product 'innovation'?

2. Should there be some standard definitions for the discriminant characteristics of a risk class? The use of undefined descriptions such as 'preferred' or 'Class A' or 'Class 1' which give only an ordinal position are not helpful in making comparisons among insurers since one insurer's class may be narrower than another's.

Disclosure - Performance record

PROPOSAL: A number of kinds of information on past performance by insurers must be supplied to buyers. The information needs for typical types of contracts might include:

1. For participating life insurance:

   (a) Rebate rates paid (presently called 'dividends') for each year in the past ten;

   (b) Proportion by which amounts paid exceed or fall short of rebates used in examples at the time the contracts were issued; this proportion might be disclosed as an average, together with an appropriate measure of dispersion.

2. For ordinary life, endowment, term insurance for more than one year and annuities;

   Lapse rates experienced by the insurer over the past ten years; there are several ways of computing this; whatever is chosen must be comparable to probabilities of terminations used in estimating expected values of monetary benefits.

3. For other-than-life insurance:

   (a) The difference between expected benefits shown to buyers in prior years, and actual benefits paid out; these differences

should be expressed as a proportion of the expected benefits that were promised; they should be disclosed for the past ten years as a series and also with some measure of the average or expected difference;

(b) The proportions of claims by insureds that have been paid by the insurer for the past ten years, for the class of insurance being sold. For liability insurance there should be a separate measure of the proportion of third parties' claims that were settled or successfully defended;

(c) The average time period from claim to payment it has taken the insurer to pay 95% (or some other proportion) of the claims ultimately paid to insureds during the year.

RATIONALE: Since an insurance contract is a promise of future benefits and services a buyer cannot be certain that all benefits and services will be performed as he is led to expect. No evidence will show with certainty what future performance will be, but people are likely to place more reliance on an insurer who has performed in accordance with his predictions in the past. Therefore, selected historical measures can be useful.

The appropriate measurements for disclosure will differ among classes of insurance. In general the measurements needed are those direct and indirect measures of past performance which together assist a buyer in reaching an informed conclusion on the reliability of future performance estimates. Many of the measures are ones which managers of an insurance company might also wish to have for internal management purposes.

TRANSITION: To begin disclosure of this kind it is only necessary to define some of the information that might be useful for a few of the commonly used kinds of contracts. As experience is gained, both the kinds of contracts affected and the kinds of information provided can be gradually expanded. Because such a large proportion of premium dollars is concentrated in a relatively few kinds of insurance contracts, a substantial impact on consumer buying might be quickly achieved.

ISSUES: 1. For which forecasts, claims and promises should appropriate performance measures for a contract be required? For which should performance measures be disclosed first?

2. For which kinds of contract should there be performance disclosure? All? Or selected types only?

3. How is the conflict to be resolved between the information needs of buyers, and the burden on insurers of providing information?

4. What methods of calculation for performance measurements should be used?

5. What format for disclosure is appropriate?